



Investment Office

P.O. Box 2749

Sacramento, CA 95812-2749

Telecommunications Device for the Deaf - (916) 795-3240

(916) 795-3400

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AGENDA ITEM 6c

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Update on Investments in Companies Doing Business in Sudan
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information Only
- IV. ANALYSIS:**

Executive Summary

On May 15, 2006, in response to the atrocities and human rights violations occurring in Sudan, the Investment Committee adopted a 9 point position statement (Attachment 1) as it pertains to companies doing business in Sudan. The Sudan Position Statement clearly communicates CalPERS' position on the situation in Sudan as well as CalPERS' belief that a constructive engagement plan is the most powerful tool to effect change at those portfolio companies whose business operations in Sudan could lead to value destruction.

CalPERS is committed to a Constructive Engagement Plan and has been diligently moving forward with it. Staff presented additional companies identified as doing business in Sudan to the Investment Committee at the May 15, 2006 meeting. Those companies were sent letters of inquiry and asked to respond by May 12, 2006. Summaries of the responses are provided in this agenda item.

After monitoring the Institutional Shareholder Services, Inc.'s (ISS) Sudan product during its development phase to its current form, staff concluded that it has evolved into a satisfactory product. Therefore, CalPERS entered into an agreement with ISS to gain access to its database of companies identified as doing business in Sudan.

The CalPERS Constructive Engagement Plan will continue to be implemented including the next steps outlined on page 6.

Background

Over the last several years, ethnic and racial tension in the Sudan has escalated to the level the U.S. Department of State characterizes as “genocide.” In recent months, it has been suggested that companies that do business in Sudan may thereby be furthering or condoning the nation’s support for terrorism or the egregious human rights violations occurring in that country. A company associated with the atrocities taking place in Sudan poses a serious risk to creating sustainable and responsible long-term value. Any such company runs myriad risks including but not limited to federal and international sanctions, substantial fines and penalties imposed by authorities, an impairment of their ability to raise capital in public markets as well as long term reputational damage.

On May 15, 2006, the Investment Committee adopted a 9 point position statement as it pertains to companies doing business in Sudan. The position statement is contingent in part upon enactment of legislation that would provide for the indemnification of CalPERS and individual board members, and the officers, agents, and employees of the system for all costs, liability, and losses. The Office of Governmental Affairs (GOVA) has been working with the author’s office to amend the indemnification language in order to meet CalPERS’ needs. GOVA will report in more detail in a separate agenda item.

With respect to the constructive engagement strategy outlined in the position statement, after identifying appropriate companies for engagement, staff plans to:

- Request companies determined to be supporting the government of Sudan and/or the military, or that are complicit in the genocide occurring in Sudan, not do business with the Sudan government while human rights violations are continuing in Darfur.
- Request that companies doing business in Sudan work with CDA Collaborative Learning Projects, United Nations Global Compact, Business Leaders Initiative on Human Rights and United Nations Development Program to improve the transparency of their business operations and complete complicity reports relating to human rights violations in Sudan.
- Request that companies doing business in Sudan work with the above entities and NGOs to bring an end to human rights violations occurring in Sudan.

Actions since May 15, 2006 are described below.

Progress Update

Company Responses to CalPERS Letters of Inquiry

In the May 15, 2006 update to the Investment Committee, additional portfolio companies¹ were identified as doing business in Sudan. Each company was sent a letter of inquiry requesting full disclosure of their direct or indirect business activities in Sudan by May 12, 2006.

To date, we have received no formal response from CNPC (Hong Kong), Reliance Industries, Rolls-Royce, or Schlumberger. Rolls-Royce responded by letter stating that they would not be able to meet the requested deadline. Staff has followed-up with CNPC (Hong Kong), Reliance Industries, and Rolls-Royce requesting they respond to our original letter of inquiry by June 23, 2006 (Attachment 2). Through conversations with Schlumberger, the company has confirmed that they are working on their response.

Below are summaries of the responses received to date. The responses are being evaluated to determine appropriate next steps with each company. Of the companies that did respond, Stolt-Nielsen reported (Attachment 3) that neither it nor any of its subsidiaries are doing any business in Sudan.

Alstom reported (Attachment 4) it is currently involved in the Merowe Dam project in Sudan. While the contract was awarded by the Ministry of Irrigation and Water resources of the Republic of Sudan, it is totally exempt of any taxes, duties and other fees or charges in Sudan, and it represents less than 0.1% of Group sales. Various Arab funds are financing the project and Alstom receives direct payments from these funds after approval of the Merowe High Dam Project Implementation Unit (MDPIU), which is an independent authority. Alstom asserts that the project does not have any connection at all with any terrorist activities or violation of human rights whatsoever and that the project marks a milestone in the economic development in Sudan. Alstom also stated that it has not done anything directly to promote and protect human rights as it is employed by the MDPIU, which is ultimately responsible for such issues.

Ericsson reported (Attachment 5) it distributes switching equipment for fixed telephony and mobile GSM systems in Sudan and that the services provided are in the nature of installation and support of the equipment delivered. Operations in Sudan are carried out through its Sudanese branch, Ericsson AB, which it established in 2002. Ericsson's customers include Sudanese Telecom Co Ltd (Sudatel) which is reportedly 30% owned by the government and Sudanese

¹ Alstom SA, CNPC (Hong Kong) Ltd., Ericsson (LM) Tel, Finmeccanica S.p.A., Marathon Oil Corp., Reliance Industries, Rolls-Royce Group PLC, Schlumberger Ltd., Stolt-Nielsen SA, Sulzer AG, ThyssenKrupp AG, and Vodafone Group PLC

Mobile Telecom Co Ltd (Mobitel), acquired in February 2006 by the Kuwaiti based telecom operator MTC from Sudatel and the pan-African mobile operator Celtel. Ericsson operates under its Code of Business Ethics and Conduct which is based on the United Nations Global Compact's ten principles. Ericsson was one of the first companies to support the United Nations Global Compact. Through Ericsson Response, the company supported the expansion of humanitarian activities in mid-2004 in the Greater Darfur region by sending an Ericsson Response volunteer to the World Food Programme and joining the information and communications technology team in Khartoum. Upon clearance from the UN, an additional volunteer will be sent to set up a GSM system in Southern Sudan for use by humanitarian organizations in Juba, in cooperation with UN Office Coordination of Humanitarian Affairs.

Finmeccanica reported (Attachment 6) its involvement in supplying civil aviation equipment that is necessary to facilitate humanitarian aid programs to the country. In 2001, a subsidiary entered into a contract with the Sudanese Civil Aviation Authority (SCAA) for the supply of two Air Traffic Control systems and subsequently two primary radars. After advice from the International Air Transport Association (IATA) office in Nairobi to SCAA to use secondary radars, ADS systems and Navigational Aids, the equipment was not installed and subsequently is not in operation. However because partial payment had been received, it was agreed that CSAA would be supplied with four secondary radars and the primary radars were returned to Finmeccanica. Secondary radars can be used exclusively for Civil Air Traffic Control purposes and are not helpful for "Dual-Use" providing a high level of safety for all aircraft at civilian airports thereby enabling humanitarian flights to be carried out successfully. Finmeccanica also stated that neither it nor any of its subsidiaries are conducting or intend to conduct any defense related activities in Sudan.

Marathon Oil reported (Attachment 7) it has held exploration interests (32.5%) in Sudan's Central Block, formerly known as Block B, since 1983 but has not participated in any business or other activities in that county since 1985 due to civil unrest and subsequent U.S. Government sanctions against Sudan. In December 2004, Marathon Oil was granted a license by OFAC that allowed the company to sign a revised exploration and production sharing agreement in order for Marathon to protect its Central Block interest. The OFAC license does not allow Marathon to conduct any operations or other business activity in Sudan and Marathon noted that it hasn't made any direct or indirect payments to Sudan as a result of the revised agreement. Marathon is a participant in the Voluntary Principles on Security and Human Rights and applies those principles wherever it operates.

Sulzer reported (Attachment 8) it has no operations in Sudan. However, if international rules and regulations are followed, Sulzer would not categorically

boycott activities in countries such as Sudan. Each project is evaluated separately to determine if it serves to improve the infrastructure of the country and the standards of living for the population while not serving to support repression. If a project meets this criteria, Sulzer may participate in it subject to approval by the respective division president. Sulzer is currently engaged in two infrastructure projects in Sudan. Given the contradictory statements in Sulzer's response, a follow-up letter (Attachment 9) was sent requesting further clarification of Sulzer's activity in Sudan.

ThyssenKrupp reported (Attachment 10) that sales of spare parts with customers in Sudan amounted to €800 in fiscal year 2004/2005 ending on September 30, 2005. The sales were generated via an external company representative with whom the business relationship has since been terminated. There are no business relationships with Sudan beyond these sales.

Vodafone reported (Attachment 11) that neither Vodafone nor any company in which Vodafone Group holds an interest has any business operations in Sudan, owns any property in Sudan or engages in any business with the government of Sudan. Vodafone's contact with Sudan is limited to wholesale roaming and interconnect arrangements that certain Vodafone subsidiaries and joint ventures have with mobile and fixed line operators in Sudan. According to Vodafone's response, these arrangements are a standard practice of a global telecommunications service and provide its customers with the ability to make and receive calls in or to over 190 countries including, in the case of certain of its operating companies, Sudan. The revenue and costs related to the roaming and interconnect arrangements are immaterial to Vodafone's business.

Company Responses to Business Leaders Initiative on Human Rights (BLIHR) and CDA Collaborative Learning Projects (CDA) Letters

On April 5, 2006, CalPERS wrote to Alcatel, Royal Dutch Shell and Siemens strongly encouraging the companies to contact the CDA and BLIHR to work with them to assess and report on the impact of their company's operations in Sudan. Alcatel responded (Attachment 12) that they have met with CDA and are currently exploring this option. Both Royal Dutch Shell and Siemens have communicated that they are considering our recommendation. As companies are identified and engaged, staff will determine whether they should also be directed to the CDA and BLIHR as well as encouraged to formally support the United Nations Global Compact.

Institutional Shareholder Services, Inc. (ISS)

Efforts to identify credible third-party consultants to assist in the identification of companies doing business in Sudan have been on-going and staff has explored

a number of possible resources including ISS. Staff has continued to monitor ISS's product from development to its current form and believes it has evolved into a satisfactory product. As a result, CalPERS recently contracted with ISS to provide access to its database of companies identified as doing business in Sudan. ISS's database will supplement staff's internal research when determining which companies should be included in CalPERS' constructive engagement plan.

Office of Foreign Asset Control (OFAC)

Staff continues to monitor the U.S. Department of the Treasury's OFAC for companies against whom OFAC has levied penalties for violating federal sanction programs specific to activities in Sudan. Since the last update to the Investment Committee in May 2006, OFAC has not reported new penalties levied for violations of the federal sanction program for Sudan.

California State Legislation

AB 2941, "Public Retirement Systems: Investments: Sudan," continues to make its way through the California State Legislature. The Office of Governmental Affairs will discuss AB 2941 in more detail in a separate agenda item.

Next Steps

CalPERS remains committed to the Constructive Engagement plan as a means to address the very serious and challenging situation in Sudan. Next steps are as follows:

- Continue to actively engage portfolio companies that are reported to have business activities that support genocide and human suffering in Sudan. After identifying appropriate companies for engagement, staff plans to:
 - Request companies determined to be supporting the government of Sudan and/or the military, or that are complicit in the genocide occurring in Sudan, not do business with the Sudan government while human rights violations are continuing in Darfur.
 - Request that companies doing business in Sudan work with CDA Collaborative Learning Projects, United Nations Global Compact, Business Leaders Initiative on Human Rights and United Nations Development Program to improve the transparency of their business operations and complete complicity reports relating to human rights violations in Sudan.

- Request that companies doing business in Sudan work with the above entities and NGOs to bring an end to human rights violations occurring in Sudan.
- Engage companies against which OFAC has levied penalties for violating federal sanction programs specific to activities in Sudan.
- Continue to seek new and reliable sources in addition to ISS to identify and engage companies doing business in Sudan.
- Continue to work with the Sudan coalition and to collaborate where appropriate.

V. STRATEGIC PLAN:

This item is a product of the 2005-2006 Global Equity Annual Plan.

VI. RESULTS/COSTS:

Over the course of last year, the primary cost to the Fund for this initiative has been significant staff time and travel costs associated with engagement activities.

Dennis A. Johnson
Senior Portfolio Manager
Corporate Governance

Christianna Wood
Senior Investment Officer
Global Equity

Russell Read
Chief Investment Officer